



## GLOBAL INVESTMENT GROWS AMERICA'S ECONOMY

### Michigan House Tax Policy Committee

OFII Testimony on Passing SB 1097 to Decouple from §163(j)  
December 3, 2018

Chair Tedder, Vice Chairs Maturen and Byrd, and members of the Tax Policy Committee:

On behalf of the Organization for International Investment (OFII), I urge the state to pass SB 1097 to decouple from the new interest expense deductibility limitations under IRC §163(j). Passing this legislation would remove a hidden corporate tax increase, prevent a hike in the cost of capital, alleviate compliance concerns and ensure the state remains competitive for international investment

OFII is a trade association representing the U.S. subsidiaries of international companies, including nearly 80 Michigan employers. OFII's membership list is enclosed. OFII ensures that policymakers understand the critical role that foreign direct investment (FDI) plays in America's economy. OFII advocates for fair, non-discriminatory treatment of international companies and promotes policies that will encourage them to grow and hire in the United States.

International companies are vital to Michigan's economy. They employ 238,100 Michiganders.<sup>1</sup> But most impressively, in the past five years, jobs provided by international firms in Michigan grew by 63.8 percent vs. the state's overall private-sector growth rate of 13.1 percent.

Enclosed is OFII's policy principles document, which outlines several reasons for why states should decouple from IRC §163(j) to ensure international competitiveness. This issue is even more important to Michigan for the following reasons:

- The ability to deduct interest as an ordinary and necessary business expense is a longstanding principle of U.S. tax policy that reduces the cost of capital, which helps encourage investment and expansion. Having more capital translates into building new plants and facilities in the United States or acquiring new assets to further grow in this market. However, if Michigan conforms to IRC §163(j), the state would limit interest deductibility, which would raise the cost of capital and increase taxes on Michigan employers. Analysis shows that complete conformity to the Tax Cuts and Jobs Act would increase Michigan's corporate tax base by 9 percent.<sup>2</sup>
- Congress limited interest deductibility to pay for a lower corporate income tax rate and 100 percent expensing. This way, companies are incentivized to invest in new assets without over-relying on debt financing. However, Michigan already decouples from federal bonus depreciation rules under IRC §168(k).<sup>3</sup> Therefore, Michigan should remain

<sup>1</sup> Data is from the U.S. Department of Commerce's Bureau of Economic Analysis. Released October 2017.

<sup>2</sup> "The Impact of Federal Tax Reform on State Corporate Income Taxes," prepared by EY for the Council on State Taxation, and its affiliate, the State Tax Research Institute. Released March 5, 2018. Of all base broadeners, the limitations on interest expense deductibility is the largest increase to the federal corporate income tax base besides the one-time tax on repatriated earnings.

<sup>3</sup> See [MCL 206.607\(1\)](#) for state law decoupling from IRC §168(k)

decoupled from IRC §163(j) because Congress intended for these provisions to act together. However, if Michigan conforms to IRC §163(j), companies would be denied 100 percent expensing on purchased assets and interest expense deductibility at the same time – two policies that inhibit investment and growth

- Michigan taxpayers file state returns on a unitary combined basis but are preparing to determine interest limitations for federal returns on a federal consolidated group basis.<sup>4</sup> This ambiguity may make state compliance to IRC §163(j) difficult for taxpayers as the state reporting group could differ from the federal reporting group.
- Michigan has excelled at attracting international investment. Nearly 1,000 global employers have operations in Michigan, and 6.5 percent of the state's workforce is employed by international investors. Conforming to IRC §163(j) would increase the cost of capital and raise taxes on Michigan employers. By decoupling, Michigan would keep its competitive edge.
- Many states that compete against Michigan regionally or for automotive and advanced manufacturing have decoupled from IRC 163(j). These states include Georgia, Indiana, Tennessee, South Carolina, Wisconsin and Connecticut.<sup>5</sup> Michigan should decouple to remain competitive for attracting capital intensive manufacturing industries.

For these reasons, OFII urges the Tax Policy Committee to pass SB 1097 to decouple from IRC §163(j) to remain competitive.

Thank you for considering this request. If you have questions, please contact Evan Hoffman, director of state government affairs, at [ehoffman@ofii.org](mailto:ehoffman@ofii.org) or 202-659-1903.

Sincerely,



Nancy McLernon  
President and CEO, Organization for International Investment

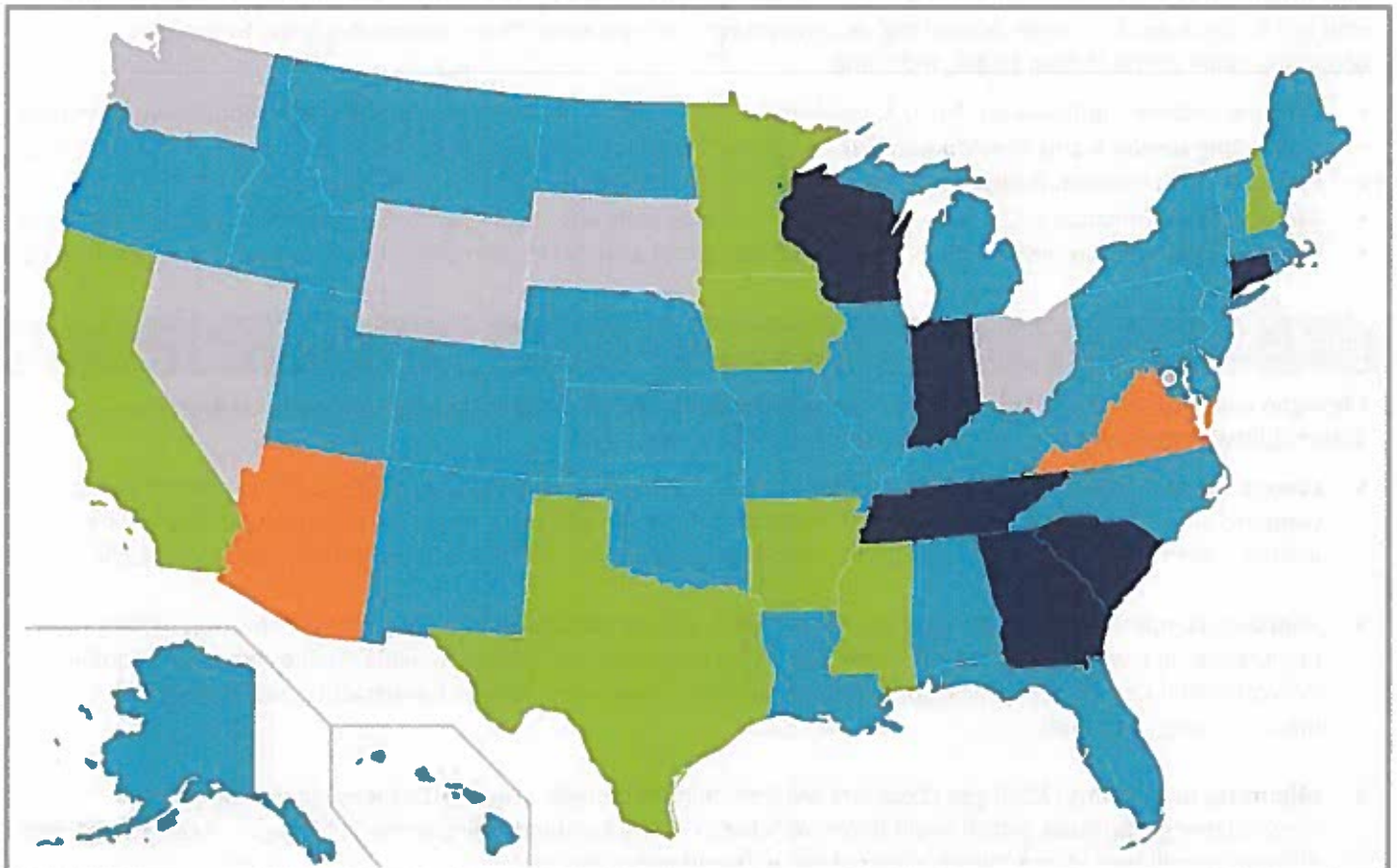
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<sup>4</sup> The U.S. Treasury Department issued a notice explaining that they intend to issue rules regarding how interest limitation and its carryforward will be determined at least on a federal consolidated group basis. However, even with this guidance, Michigan taxpayers file on a unitary combined basis, which could differ from their federal consolidated group, creating complexities and uncertainties.

<sup>5</sup> Georgia decoupled from IRC §163(j) in [H.B. 918](#), enacted March 2. Wisconsin decoupled from IRC §163(j) in [A.B. 259](#), enacted April 3. Indiana decoupled from IRC §163(j) in [H.B. 1316](#), enacted May 14. Connecticut decoupled from IRC §163(j) in [S.B. 11](#), enacted May 31. Tennessee decoupled from IRC 163(j) starting in 2020 in [SB 2119](#), enacted May 21. South Carolina decoupled from IRC §163(j) in H. 5341, enacted October 2.



## Conformity to IRC §163(J) Across The States; Why S.B. 1097 is Necessary



*The Tax Cuts and Jobs Act changed IRC 163(j) to limit the deductibility of interest expense. This provision was part of federal tax reform to help pay for a lower federal corporate income tax rate and 100 percent expensing. States that conform to IRC 163(j) will also limit taxpayers' deductibility of interest expense. However, many states have decoupled from IRC 163(j) for the reasons outlined in this document.*



**DECOUPLES FROM 163(J) THROUGH ENACTED LEGISLATION**



**CONFORMS TO 163(J) AS OF 1/1/18**



**DOES NOT ADOPT 163(J) AS OF 1/1/18**



**FOR 2018 TAX YEAR – IRC ADOPTED AS OF 1/1/2017, EFFECTIVELY DECOUPLING FROM 163(J)**

## FEDERAL TAX REFORM HAS UNINTENDED CONSEQUENCES FOR STATES THAT CONFORM

The Tax Cuts and Jobs Act was a seismic shift in tax policy that dropped the federal corporate income tax rate and added new base broadeners. States that conform to the new tax code in its entirety will increase a state's corporate tax base by 12 percent on average according to analysis by EY published in March 2018.

## INTERNATIONAL INVESTMENT DRIVES MICHIGAN'S ECONOMY FORWARD

International companies employ 7.1 million U.S. workers, including 238,100 Michigan workers. In the past five years, jobs provided by international firms in Michigan grew by 63.8 percent vs. the state's overall private-sector growth rate of 13.1 percent. This is the second highest growth rate in the nation. These companies bring tremendous economic value to the United States, including:

- **Offering better compensation:** Pay U.S. workers 26 percent more in compensation than the economy-wide average.
- **Supporting research and development (R&D):** Spend \$60 billion annually on U.S. R&D, or 16 percent of all U.S. R&D.
- **Producing U.S. exports:** Produce over 25 percent of U.S. exports, producing over \$1 billion a day in U.S. exports.
- **Adding value:** Contribute \$2.5 billion a day to the U.S. economy and pay 19 percent of federal corporate income tax.
- **Growing U.S. manufacturing:** Responsible for 54 percent of all new U.S. manufacturing jobs over the past five years.

## MICHIGAN SHOULD PASS S.B.1097 TO DECOUPLE FROM IRC §163(J)

Michigan conforms to the federal Tax Cuts and Jobs Act but should decouple from the new interest expense deductibility limitations under IRC §163(j) for the following reasons:

- **Lowers the cost of capital:** Deducting interest expense lowers the cost of capital, which is a fundamental part of a company's investment calculation. Without decoupling from IRC §163(j), interest expense deductibility will be limited, which increases the cost of capital and creates a higher hurdle rate for an investment to be profitable.
- **Improves competitiveness:** Many states that compete against Michigan regionally or for automotive and advanced manufacturing have decoupled from IRC 163(j). These states include Georgia, Indiana, Tennessee, South Carolina, Wisconsin and Connecticut. Michigan should decouple to remain competitive for attracting capital intensive manufacturing industries.
- **Minimizes uncertainty:** Michigan taxpayers will determine their federal interest expense limitation on a consolidated group basis, which could differ from their unitary combined filing group in Michigan. Reconciling these differences will lead to complexity in complying with and enforcing the law.
- **Incentivizes investment:** Congress only limited interest deductibility to pay for a lower federal corporate income tax rate and 100 percent expensing. This way, companies are incentivized to invest in new assets without over-relying on debt. However, Michigan decouples from federal 100 percent expensing rules under IRC §168(k). Therefore, Michigan should decouple from IRC §163(j) because Congress intended for these provisions to act together. Without decoupling from IRC §163(j), Michigan taxpayers would be denied 100 percent expensing on purchased assets and interest expense deductibility at the same time – two policies that inhibit investment and job creation.
- **Ensures global competitiveness:** Michigan competes against other states and countries for international companies. Consider how international companies grow and expand in the United States. They often borrow from a related party or bank to finance investment in the United States. Disallowing interest expense deductibility could alter the investment calculation for international companies compared to other jurisdictions which do allow interest expense deductibility. This is important because global competition for international investment has never been greater.

For additional information on OFII or with questions about conformity, please contact Evan Hoffman, director of state government affairs, at [ehoffman@ofii.org](mailto:ehoffman@ofii.org).



# Decouple from IRC §163(j) to Be Competitive for International Investment

## International Investment Grows America's Economy

- **Supporting Millions of High-Quality Jobs:** International companies employ 6.8 million U.S. workers providing compensation that is 24 percent higher than the economy-wide average.
- **Growing America's Manufacturing Sector:** International firms are responsible for one-in-five of all U.S. manufacturing jobs. In fact, two-thirds of the manufacturing jobs created in the past few years can be attributed to FDI.
- **Fueling American Innovation:** American scientists and engineers employed by international companies are leading our nation's innovation advantage. International employers spend more than \$57 billion on research and development activities, or 16 percent of America's private-sector R&D.
- **Exporting American-Made Goods:** U.S. workers of international companies produce 23 percent of U.S. exports, shipping nearly a billion dollars in goods a day to customers around the world.
- **Importing World-Class Workforce Training Programs:** These companies also "import" world-class workforce training programs and help spur U.S. productivity.
- **FDI Makes America's Economy More Resilient:** After all, international companies help broaden the U.S. economy, open new markets and give other countries a stake in America's economic success.<sup>1</sup>

## Conformity Done Right Will Increase Competitiveness for International Investment

The new federal tax law drops the federal corporate income tax rate to 21 percent and adds new base broadeners. Given this seismic shift in tax policy, conformity to all Internal Revenue Code provisions could have unintended state-level policy consequences as federal base broadeners were carefully considered and implemented alongside the rate reduction to achieve policy objectives. Without a review of these state-level unintended consequences, conforming to the new tax code in its entirety could reduce a state's international competitiveness.

**Therefore, states should decouple from the new interest expense limitations imposed under IRC §163(j) to best position themselves for international investment. Decoupling from IRC §163(j) is also smart tax policy for the following reasons:**

- States would act consistently with the federal tax law's policy objective of increasing competitiveness for investment and spurring economic growth and job creation.
- States would remove threats of multiple taxation and ensure fair apportionment of income.
- States would avoid creating computational uncertainty and unnecessary administrative complexity for both taxpayers and taxing authorities.

<sup>1</sup> All data is the latest available from the U.S. Department of Commerce, released October 2017.

## States Should Decouple from the New Interest Expense Limitations Under IRC §163(j)

The new federal tax law limits interest deductibility to 30 percent of a taxpayer's adjusted taxable income. This rule applies to almost all taxpayers<sup>2</sup> and to both related party and unrelated party interest expense. It also allows for unlimited carryforwards of disallowed interest expense. States should decouple from IRC §163(j) for the following reasons:

- **Taxpayers could face higher effective state tax rates through conformity to IRC §163(j):** Congress imposed tighter interest expense limitations to pay for a lower federal tax rate, accelerated depreciation and immediate expensing. Unless states also lower rates and conform to the new federal bonus depreciation and immediate expensing rules, conforming to IRC §163(j) would misalign with congressional intent and could increase every state taxpayer's effective tax rate, as described below.<sup>3</sup>
  - First, taxpayers face tighter interest limitations to help pay for a lower federal corporate income tax rate. A corporate taxpayer's state tax liability may increase significantly if a state conforms to IRC §163(j) without a simultaneous lowering of the state's corporate income tax rate.
  - Second, as a preliminary matter, states that decouple from the new bonus depreciation and immediate expensing rules in IRC §168(k) and §179 should also decouple from the IRC §163(j) interest limitations. Congress clearly intended the interest expense limitation rule to work concurrently with new bonus depreciation and immediate expensing rules. Together, these rules encourage businesses to invest immediately in the United States, but without over-relying on debt financing. However, most states decouple from federal bonus depreciation schedules and immediate expensing rules. Therefore, conforming to §163(j) without conforming to IRC §168(k) and §179 would misalign with Congress's intent and result in corporate state tax increases.
- **Taxpayers and tax administrators would face significant federal and multistate complexity if the states conform to IRC §163(j):** The new federal tax law applies the new 30 percent interest deductibility limitation at the "taxpayer" level – a term undefined in the statute. To date, the U.S. Department of Treasury has not issued guidance regarding how the interest limitation and its carryforward will be determined.<sup>4</sup> Therefore, many taxpayers could be confused by how the interest limitation will apply because their state filing group may differ from their federal filing group.<sup>5</sup> This ambiguity would make state compliance to IRC §163(j) almost impossible for taxpayers. States that conform to IRC §163(j) could end up increasing administrative costs for both taxpayers and taxing authorities.

<sup>2</sup> It does not apply to real estate, public utilities, farmers or "floor plan financing" (essentially, automobile dealership inventory carrying costs).

<sup>3</sup> *The Impact of Federal Tax Reform on State Corporate Income Taxes*, prepared by EY for the Council on State Taxation, and its affiliate, the State Tax Research Institute. Released March 5, 2018. The report shows that state corporate income tax bases will increase by 12 percent on average over a 10-year period, with significant variations between the states. The report cites conformity to IRC §163(j) as one provision, among many cited, that will contribute to this increase in state corporate income taxes.

<sup>4</sup> While guidance has yet to be issued, federal tax policy officials have publicly announced that the U.S. Treasury Department will issue guidance confirming that the interest limitation and its carryforward will, at a minimum, be determined at the federal consolidated group level. They have also indicated that the guidance will provide clear rules for allocating the interest expense limitation, consistent with other long-standing and existing consolidated group attribute allocation rules (e.g., deferred intercompany transactions, consolidated IRC §382 loss limitation rules, separate return limitation year (SRLY) rules) intended to fairly allocate the limitation among members of the group respecting separate entity reporting. However, even with this guidance, a taxpayer's state filing group, which may be on a standalone or a group basis, may differ from its federal filing group. This would create similar complexities and uncertainties.

<sup>5</sup> A taxpayer's state reporting group often looks different than its federal filing group. For instance, over twenty states require taxpayers to file separate company returns under which group reporting is not allowed. In many cases, a taxpayer's state reporting group includes many more entities than its federal filing group. For example, depending upon a taxpayer's unitary group, members of multiple federal consolidated groups could be members of the same state reporting group, or the state could require worldwide or water's-edge reporting that includes foreign corporations that are expressly excluded from the federal consolidated group. A taxpayer's state group could also include fewer or more entities than its federal group. For instance, the federal group may consist of multiple state unitary groups or a state may only allow a group report for corporations which have nexus with the state or may exclude corporations engaged in certain kinds of business from the group because they are not subject to state income taxes (e.g., insurance companies and banks).

- **In addition to the complexity, conforming to IRC §163(j) may result in tax costs unintended by the federal provision:** If the U.S. Department of Treasury clarifies that IRC §163(j) should apply on a group basis, state application of IRC §163(j) on any other basis may result in an interest disallowance where none would occur at the federal level. Companies structure their debt financing knowing that their taxable income is computed on a consolidated basis at the federal level, which is why Treasury is expected to clarify that the new IRC §163(j) limit will apply at least at a consolidated level. If states were to apply these limits differently, taxpayers could see more significant limitations on interest expense deductibility or higher state taxes. In addition, applying limitations differently would create complex and costly administration for both taxpayers and taxing authorities.
- **Taxpayers' interest deductibility is already limited by states, making conformity to IRC §163(j) unnecessary:** Most states already limit or otherwise disallow interest deductions for their own tax policy purposes. In many cases, the states were far ahead of the federal government in this area and their rules may be even more restrictive. For example, many states limit the deductibility of interest paid to related parties through addback requirements. These are effective tools that prevent state tax base erosion. They also provide narrow exceptions, which include among others, for interest paid to related parties in countries that have a comprehensive tax treaty with the United States or that is subject to tax by another jurisdiction. It is unclear how the new interest expense limitation rules in IRC §163(j) would conflict with existing state addback rules. If states conform to IRC §163(j), a possibility exists of duplicate limitation on interest deductibility, resulting in double taxation of the affected state taxpayers. Decoupling from IRC §163(j) would minimize this uncertainty and unnecessary complexity.
- **Decoupling from IRC §163(j) would keep states competitive for international investment:** Consider how international companies grow and expand in the United States. They often borrow from a related party or bank to finance investment in the United States. Imposing tighter interest limitations at the state level, without offering a lower tax rate or providing accelerated depreciation and immediate expensing, would increase the cost of capital and impose a higher threshold to be profitable. This new hurdle could result in an investment being altered in a way that firms no longer see the return needed to justify the investment. They then could make that investment in another state.

For additional information on OFII or with questions about conformity, please contact Evan Hoffman, director of state government affairs, at [ehoffman@ofii.org](mailto:ehoffman@ofii.org).

### **About OFII**

OFII is the only organization in Washington focused exclusively on supporting the international business. OFII members are among the largest international companies with operations in the United States. While more than 60 percent of all international companies in the United States have fewer than 1,000 U.S. employees, OFII members each employ on average of more than 12,000 Americans. OFII advocates for fair, non-discriminatory treatment of foreign-based companies and promotes policies that will encourage them to establish U.S. operations, which in turn increases American employment and U.S. economic growth.

# 2018 OFII Membership List

**ABOUT OFII** The Organization for International Investment is a not-for-profit business association in Washington, D.C., representing the U.S. operations of many of the world's leading international companies. OFII advocates for fair, non-discriminatory treatment of foreign-based companies and promotes policies that will encourage them to establish U.S. operations, increase American employment and boost economic growth to ensure the United States remains the top location for global investment. For more information, please visit [www.OFII.org](http://www.OFII.org).

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Ahold Delhaize  
Airbus Group, Inc.  
Air Liquide USA  
Akzo Nobel Inc.  
Alfa Laval, Inc. (USA)  
Alibaba Group  
Allianz of North America  
Anheuser-Busch  
APG  
APL Limited  
Aptiv  
Arca Continental  
Arup  
Astellas Pharma US, Inc.  
AstraZeneca Pharmaceuticals  
AVANGRID

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Balfour Beatty  
Barrick Gold Corp. of North America  
Barry Callebaut  
BASF Corporation  
Bayer Corp.  
BBA Aviation  
B. Braun Medical, Inc.  
BHP Billiton  
BIC Corp.  
Bimbo Bakeries  
bioMérieux  
BlueScope Steel North America  
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Boehringer Ingelheim Corp.  
Bombardier Inc.  
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BP  
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Brookfield Asset Management  
BT  
Bunge Ltd.  
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CGI Group  
Chubb  
CN  
CNH Industrial  
Compass Group USA  
Continental Corporation  
Cosentino Group  
CSL Behring  
Credit Suisse Securities (USA)  
CRH Americas, Inc.

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Daikin North America  
Daimler  
Danfoss  
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Dassault Falcon Jet Corp.  
Dassault Systemes  
DENSO  
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Diageo, Inc.  
Direct Energy  
DLI North America  
DSM North America

## E

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Emera, Inc.  
Enel Green Power North America  
ENGIE  
E.ON North America  
Ericsson  
Essilor USA  
Experian

## F

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Fresenius Kabi USA, LLC.

Fresenius Medical Care  
FUJIFILM Holdings America

## G

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Getinge Group  
GKN America Corp.  
GlaxoSmithKline  
Global Atlantic Financial Company  
Grifols  
Grundfos

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Huhtamaki  
Husqvarna AB  
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Imerys  
Infineon Technologies Americas Corp.  
InterContinental Hotels Group  
Indivior PLC  
Ipsen Biopharmaceuticals, Inc.

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Kerry  
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L'Oréal USA, Inc.  
Louisville Corporate Services, Inc.  
LVMH Moët Hennessy Louis Vuitton  
LyondellBasell

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MAHLE Industries  
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Marubeni America Corporation  
Marvell Semiconductor  
Mazda  
McCain Foods USA  
Medtronic, Inc.  
Michael Kors  
Michelin North America, Inc.  
Mitsubishi Electric US, Inc.  
Mizuho Bank, Ltd.

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Nestlé USA, Inc.  
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Nissan  
Nokia  
Nomura Holding America, Inc.  
Novartis Corporation  
Novo Nordisk

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ORIX  
Ørsted North America Inc.

## P

Panasonic Corp. of North America  
Pearson Inc.  
Permobil  
Pernod Ricard USA  
Philips North America LLC  
Pirelli

## POSCO

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QBE the Americas

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RELX Group  
Restaurant Brands International  
Rio Tinto America  
Roche Holdings, Inc.  
Rolls-Royce North America Inc.  
Royal Bank of Canada

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SAP America  
Sasol Chemicals (USA) LLC  
Schindler Elevator Corporation  
Schlumberger  
Schneider Electric USA  
Schott North America  
SCOR  
Shell Oil Company  
Shire Pharmaceuticals  
Sibelco Group  
Siemens Corporation  
Signify  
Smith & Nephew, Inc.  
Smithfield  
Smiths Group  
Sodexo  
Solvay America  
Sony Corporation of America  
Spotify  
SSAB Americas  
Standard Chartered Bank  
Suez North America  
Sumitomo Corp. of America  
Swiss Re America Holding Corp.  
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Thales USA, Inc.  
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TOTAL Holdings USA, Inc.  
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Trafigura  
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UCB  
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Volkswagen of America, Inc.  
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